Accounting for Real Estate Developers

Presented by:
CA. Sandeep Shah
Partner – N A Shah Associates
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- Background
- Accounting under Indian GAAP
- Accounting under IFRS
- Exposure draft-Revenue from Contracts with Customers-IFRS
- Tax Accounting Standards
Background

- Exponential growth in real estate sector

- Real estate transactions is unique as compared to normal transaction of sale of goods & services
  - Diverse format of transaction structure across India

- A real estate project spreads over more than one accounting period

- The standard on revenue recognition – AS 9 does not provide adequate clarity on timing and basis for recognizing revenue for real estate transaction
Background

- Divergent views and accounting treatment / practices amongst various companies involved in real estate development

- Other challenges
  - Need to make accounting estimates - project cost, revenue, etc
  - Valuation of closing stock
  - Tax treatment / other related issues
Accounting under Indian GAAP
Applicable accounting norms

- AS-7 on construction contracts applies to contractors and in most cases real estate developers would not fall under definition of contractor.

- As per AS-9 on revenue recognition, revenue should be accounted when significant risk and rewards of ownership are transferred to the buyer.

- Guidance note issued by ICAI in May 2006 on Recognition of Revenue by Real Estate Developers.

- Revised Guidance note issued by ICAI in February 2012 on Accounting for Real Estate Transaction.
Applicable accounting norms

- As per the earlier guidance note
  - Revenue should be recognized when
    - Transfer of risk and rewards of ownership
    - No uncertainty as regards collection of the amount
  - If the above conditions are satisfied then revenue is recognized by applying principles of percentage of work completion method as per principles provided in AS-7

- As per the revised guidance note
  - If the economic substance of the transaction is similar to construction contracts, principles of AS-7 should be applied
  - If real estate transaction is in principle similar to sale of goods and services, principles of AS-9 should be applied

- Detailed guidance on application of percentage of completion method is provided in the revised guidance note
Need for revised GN

- To stop divergent practices in recognition of revenue

- Old GN was not addressing certain relevant and pertinent issues, e.g. it did not provide sufficient guidance on POCM
  - Whether land cost should be included in computing the POCM for threshold limit and for recognizing revenue
  - Whether interest / borrowing cost should be included in computing percentage completion
  - What should be the minimum threshold for commencing revenue recognition

- The new guidance note has larger scope and applicability and is much more detailed than the earlier version
  - It also provides illustration to explain the method of calculating revenue
# Accounting policies of some real estate cos.

<table>
<thead>
<tr>
<th>Name</th>
<th>Accounting Policy</th>
<th>Gist</th>
</tr>
</thead>
</table>
| Orbit Corporation Limited      | Revenue is recognised under “Percentage Completion Method” i.e. it is based on percentage of actual costs incurred to date to the total estimated costs subject to such actual cost incurred being 25 per cent or more of the total estimated project cost. Land costs are not included in actual costs and estimated costs. | - POCM  
- 25% threshold  
- land cost not included for percentage completion                                                                 |
## Accounting policies of some real estate cos.

<table>
<thead>
<tr>
<th>Name</th>
<th>Accounting Policy</th>
<th>Gist</th>
</tr>
</thead>
<tbody>
<tr>
<td>DLF</td>
<td>Revenue is recognized on “Percentage Completion Method” i.e. revenue is based on percentage of actual project costs to estimated project costs subject to such actual cost incurred being 30 per cent or more of the total estimated project cost. Estimated project cost includes cost of land/ development rights, borrowing costs, overheads, estimated construction and development cost of such properties. Review of estimates costs are done periodically and effects of changes are recognized and where project cost is estimated to exceed project revenue loss is recognized immediately. Revenue from SEZ projects is recognized on the basis mentioned above and in accordance with Co-developer Agreements / Memorandum of understanding.</td>
<td>–POCM</td>
</tr>
<tr>
<td></td>
<td></td>
<td>–30% threshold</td>
</tr>
<tr>
<td></td>
<td></td>
<td>–land cost included</td>
</tr>
<tr>
<td>HDIL</td>
<td>Company follows “Project Completion Method” i.e. expense incurred during the year are debited to work-in-progress account and income is accounted when the projects get completed/substantially completed. Revenue is recognized to the extent it is probable and can be reliably measured.</td>
<td>–Project completion method</td>
</tr>
</tbody>
</table>
Salient features of new GN
Applicability & Scope of GN

- Applicability – Transition provision
  - Projects commencing on or after 1st April 2012
  - Projects which have commenced earlier but where revenue is being recognized for the 1st time on or after 1st April 2012
  - Option to apply this GN from an earlier date provided the GN is applied to all transactions after the chosen (earlier) date

- Covers all types of real estate transactions – land, plots with and without development, development agreement, building, TDR, etc.

- GN does not apply to transaction covered in scope of AS 10, AS 12, AS 19 and AS 26
Definition of project

- **What is Project?**
  - Relevant to identify since POCM is based on the same
  - Project is smallest group of unit / plot/ saleable space which are linked with a common set of amenities in such a manner that unless the common amenities are made available and functional, the units / plot / space cannot be put to their intended effective use
  - Large developments can be split into smaller projects if the basic conditions are fulfilled
    - For example each tower or a group of tower could be designated as project or a complete township could also be considered as a project
    - The classification would depend on facts and circumstances of each case
Project cost

- Elements of Project Cost
  - Cost of land & development rights - including rehabilitation cost, brokerage cost, stamp duty etc
  - Borrowing cost – directly incurred on the project or which are apportioned to the project
  - Construction & development cost relating to project
Project cost

- Construction & development cost
  - Project specific cost - land conversion charges, approval cost, site labour, material used in construction and development of property, depreciation of plant & equipment, cost of design & technical assistance, warranty costs, third party claims etc.
  - Cost that may be attributable to project activity in general - Insurance cost, construction overheads etc
    - Cost like general administration, selling expenses etc should not be included in the cost of construction
    - Unconsumed inventory, payments to sub-contractors in advance of work performed are excluded.
Project revenue

- Project Revenue
  - Revenue from sale of plots,
  - Undivided share in land,
  - Sale of finished and semi-finished structures,
  - Sale of development rights,
  - Consideration for amenities, interior etc
## Accounting Principles - real estate transactions

- **Accounting for real estate transactions**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Key Principles / Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the real estate transaction are in substance similar to sale of goods</td>
<td>- Transfer of significant risk &amp; reward of ownership</td>
</tr>
<tr>
<td></td>
<td>- Effectively handed over possession to the buyer</td>
</tr>
<tr>
<td></td>
<td>- No uncertainty as regards consideration and ultimate collection</td>
</tr>
<tr>
<td></td>
<td>- AS-9 to be followed</td>
</tr>
<tr>
<td>If the real estate transactions have the same economic substance like a</td>
<td>- Duration of project more than 12 months</td>
</tr>
<tr>
<td>construction contract</td>
<td>- Features similar to construction contract [like land development</td>
</tr>
<tr>
<td></td>
<td>- Individual units contracted to different buyers but are inter-</td>
</tr>
<tr>
<td></td>
<td>- If above are satisfied – percentage of completion method to be</td>
</tr>
<tr>
<td></td>
<td>- development etc] &amp; construction &amp; development forms a significant</td>
</tr>
<tr>
<td></td>
<td>- inter-dependent on common amenities</td>
</tr>
<tr>
<td></td>
<td>- method to be followed</td>
</tr>
</tbody>
</table>
## Accounting Principles-real estate transactions

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Key Principles / Conditions</th>
</tr>
</thead>
</table>
| Sale of land & plots        | ■ Sale of land without development should be recognized when conditions mentioned in AS 9 are fulfilled  
                                ■ In case of sale of developed plots, if the development activity is significant then POCM to be applied |
| Multiple Element Contracts  | ■ Contract consideration should be split into different identifiable components including one for construction and delivery of real estate units  
                                ■ Consideration received or receivable should be allocated to each component based on fair market value of each component |
Accounting Principles-real estate transactions

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Accounting for Transferable development Rights (TDR)

- TDR acquired by way of direct purchase or on development or construction of built-up area, the cost of acquisition would be the cost or purchase or amount spent on the development or construction of the built-up area respectively.

- When TDR are acquired by way of giving up rights over existing structure or open land, the development right should be accounted at lower of fair market value (FMV) or at net book value of the asset given up.
Principles for application of POCM

- Application of percentage of completion method
  - Percentage completion method to be applied only when following conditions are satisfied
    - Total project revenue can be estimated
    - Probable that economic benefits would flow to the entity
    - The project cost to complete the project and stage of completion can be reliably measured
    - Project cost attributable to the project can be clearly identified & measured so that the cost incurred can be compared with prior estimates
Conditions before applying POCM

- Additional conditions for application of percentage of completion method
  - All critical approvals necessary for the commencement of the project are obtained
    - environmental clearance,
    - approval of plans,
    - designs,
    - title to land or other rights for development,
    - change in land use etc
Conditions before applying POCM

- Stage of completion of the project reaches a reasonable level of development.
  - Reasonable level is not attained if the expenditure on Construction & Development (this excludes cost of land and borrowing cost) is less than 25% of the estimated Construction & Development cost of the project.

- Atleast 25% of the saleable area is secured by contracts or agreement or other legally enforceable documents with buyers.

- Atleast 10% of the contracted amount are realized at the reporting date in respect of each of the contracts.
  - The compliance of this clause should be done agreement-wise and not on overall basis.
Recognizing revenue / profit under POCM

- Computation of percentage completion & revenue recognition
  - For computation of revenue, the stage of completion of the project should be arrived at with reference to entire project cost incurred including land cost, Borrowing cost, Construction and Development cost etc.
  - The revenue from the project by reference to stage of completion should not exceed the total estimated revenue from eligible contracts.
  - The project cost recognized in the statement of profit and loss account are matched with the revenue recognized.

- When the project cost exceed the eligible project revenue the expected loss should be recognized immediately.
Recognizing revenue / profit under POCM

- Other points relating to percentage completion method
  - The percentage completion method is applied on a cumulative basis in each reporting period to the current estimate of project revenue and project cost.
  - Change in estimate of project cost & revenue is considered to change in accounting estimate
  - Determination of the stage of completion of the project with reference to project cost incurred is preferred,
  - Guidance Note does not prohibit methods like survey of work, technical estimation etc for determining of stage of completion provided the revenue as per other methods is not higher than the revenue on the basis of project cost incurred.
Recognizing revenue / profit under POCM

- Where individual contracts are a part of the single project although risk and reward are transferred on signing of a legally enforceable document but significant performance in respect of the remaining components of the project is pending, revenue is postponed until the performance of the remaining components is considered to be completed.
Disclosures

- Disclosure requirement
  - Project revenue recognized & method used
  - Method of determination of stage of completion
    - Aggregate amount of cost incurred and profit recognized,
    - Amount of advances received, work in progress, inventory and
    - Unbilled revenue i.e. excess of revenue over actual bills raised
Illustration on Application of POCM – Case I

<table>
<thead>
<tr>
<th>Facts</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total saleable area</td>
<td>20,000 sqft</td>
</tr>
<tr>
<td>land cost</td>
<td>Rs 300 lacs</td>
</tr>
<tr>
<td>Estimated construction and development cost</td>
<td>Rs 300 lacs</td>
</tr>
<tr>
<td>Total area sold</td>
<td>5000 sqft</td>
</tr>
<tr>
<td>Total sale agreement value</td>
<td>Rs 200 lacs</td>
</tr>
<tr>
<td>Amount realized</td>
<td>Rs 50 lacs</td>
</tr>
<tr>
<td>Cost incurred including land cost</td>
<td>Rs 360 lacs</td>
</tr>
</tbody>
</table>

Solution:
- Percentage of completion for threshold limit is 20%
- Area sold is 25% of total saleable area
- Amount realized exceeds 10% of agreement value
- Final answer – No revenue to be recognized as threshold limit not achieved
### Illustration on Application of POCM – Case II

<table>
<thead>
<tr>
<th>Facts</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total saleable area</td>
<td>20,000 sqft</td>
</tr>
<tr>
<td>land cost</td>
<td>Rs 300 lacs</td>
</tr>
<tr>
<td>Estimated construction and development cost</td>
<td>Rs 300 lacs</td>
</tr>
<tr>
<td>Total area sold</td>
<td>5,000 sqft</td>
</tr>
<tr>
<td>Total sale agreement value</td>
<td>Rs 200 lacs</td>
</tr>
<tr>
<td>Amount realized</td>
<td>Rs 50 lacs</td>
</tr>
<tr>
<td>Cost incurred including land cost</td>
<td>Rs 390 lacs</td>
</tr>
</tbody>
</table>

**Solution:**

- Percentage of completion for threshold limit is 30%
- Area sold is 25% of total saleable area
- Amount realized exceeds 10% of agreement value
- Final answer –
  - Revenue to be recognized at 65% of Rs 200 lacs i.e. Rs 130 lacs
  - Cost \[\frac{5000}{20,000} \times 390\] Rs 97.50 lacs
  - Work in progress – Rs 292.50 lacs
  - Profit – Rs 32.50 lacs
Key take-away / learning

- More clarity in terms of applicability of accounting standards / principles. This would ensure uniformity and comparability

- Percentage completion method to be applied when nature of contract is similar to construction contract in other cases AS-9 to be applied

- The manner in which POCM to be applied further elaborated.
  - Distinction made in method of computation of percentage completion for threshold limit of 25% & method of computation of percentage completion for recognizing revenue
  - Land and borrowing cost to be excluded for calculating threshold limit and while computing the revenue, it should be included

- Additional conditions introduced for commencing revenue recognition (like % of area sold, % of money realized, approvals, etc.)

- Additional disclosure requirements
## Old guidance note vs. revised guidance note

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Old Guidance Note</th>
<th>Revised Guidance Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective</td>
<td>Recommended principles of revenue recognition for real estate transactions</td>
<td>More broader – also provides the basis in which principles of AS 7 and AS 9 to be applied, more detailed principles for recognizing revenue, etc.</td>
</tr>
<tr>
<td>Definition of term</td>
<td>Referred to land as well as building</td>
<td>Refers to land as well as buildings and rights in relation thereto</td>
</tr>
<tr>
<td>real estate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scope</td>
<td>No specific scope but only covered principles of revenue recognition</td>
<td>Covers all forms of real estate transactions like sale of plots of land with or without development, development and sale of residential and commercial premises, Acquisition, utilization and transfer of TDR, Joint Development, Redevelopment etc</td>
</tr>
</tbody>
</table>
## Old guidance note vs. revised guidance note

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Old Guidance Note</th>
<th>Revised Guidance Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitions</td>
<td>No definitions provided</td>
<td>Definition of various terms used in the guidance note are provided [example – project, project cost etc]</td>
</tr>
</tbody>
</table>
| Revenue Recognition  | If conditions specified by AS-9 for revenue recognition satisfied than revenue to be recognized using principles of AS-7 | If economic substance of transactions is like construction contract revenue should be recognized using principles of AS-7  
If the economic substance is similar to sale of goods than principles of AS-9 should be used |
<p>| Application of POCM  | No guidance provided                                                               | Detailed guidance note provided. Also additional conditions like threshold limit, collection, minimum sales etc defined |</p>
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Old Guidance Note</th>
<th>Revised Guidance Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calculation of threshold limit</td>
<td>No guidance provided</td>
<td>Guidance provided as to what items should be considered for calculation of threshold limit of 25%</td>
</tr>
<tr>
<td>25%</td>
<td>AS-7 was required to referred to for guidance</td>
<td></td>
</tr>
<tr>
<td>Acquisition, Utilization and</td>
<td>Not covered</td>
<td>Covered</td>
</tr>
<tr>
<td>sale of TDR</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disclosure requirements</td>
<td>No disclosure requirements prescribed other than disclosure of accounting policy</td>
<td>Additional disclosure requirements have been prescribed</td>
</tr>
</tbody>
</table>
# Old guidance note vs. revised guidance note – Impact analysis

<table>
<thead>
<tr>
<th>All conditions specified in 5.3 of GN satisfied</th>
<th>Revised GN</th>
<th>Old GN (land cost was excluded)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total saleable area</td>
<td>20000 sft</td>
<td></td>
</tr>
<tr>
<td>Land cost</td>
<td>300.00 lacs</td>
<td></td>
</tr>
<tr>
<td>Estimated construction and development cost</td>
<td>300.00 lacs</td>
<td></td>
</tr>
<tr>
<td>Total area sold</td>
<td>5000 sft</td>
<td></td>
</tr>
<tr>
<td>Total sale agreement value</td>
<td>200.00 lacs</td>
<td></td>
</tr>
<tr>
<td>Amount realized cost incurred including land cost</td>
<td>390.00 lacs</td>
<td></td>
</tr>
<tr>
<td>Total estimated cost</td>
<td>600.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Actual cost incurred</td>
<td>390.00</td>
<td>90.00</td>
</tr>
<tr>
<td>stage of completion</td>
<td>65%</td>
<td>30%</td>
</tr>
<tr>
<td>Revenue to be recognised</td>
<td>130.00</td>
<td>60.00</td>
</tr>
<tr>
<td>cost allocated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land cost</td>
<td>48.75</td>
<td>22.50</td>
</tr>
<tr>
<td>cost of construction</td>
<td>48.75</td>
<td>22.50</td>
</tr>
<tr>
<td>Total</td>
<td>97.50</td>
<td>45.00</td>
</tr>
<tr>
<td>Profit for the period</td>
<td>32.50</td>
<td>15.00</td>
</tr>
</tbody>
</table>
**Issue for consideration**

Whether Default rectified subsequent to reporting date but before adoption of accounts can be considered for revenue recognition (para 5.6). Also whether para 5.6 is capable of interpretation as under:

<table>
<thead>
<tr>
<th></th>
<th>Flat 1</th>
<th>Flat 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreement Value</td>
<td>10,000</td>
<td>8,000</td>
<td>18,000</td>
</tr>
<tr>
<td>POCM</td>
<td></td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Revenue to be recognized</td>
<td></td>
<td></td>
<td>9,000</td>
</tr>
<tr>
<td>Option 1:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Default on reporting date</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Revenue from eligible contract</td>
<td></td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Revenue to be recognized not to exceed Total revenue of Eligible contracts (Para 5.6)</td>
<td></td>
<td></td>
<td>9,000</td>
</tr>
<tr>
<td>Option 2:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Default on reporting date</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Revenue from eligible contract</td>
<td></td>
<td></td>
<td>8,000</td>
</tr>
<tr>
<td>Revenue to be recognized not to exceed Total revenue of Eligible contracts (Para 5.6)</td>
<td></td>
<td></td>
<td>8,000</td>
</tr>
</tbody>
</table>
Issue for consideration

Real Estate developer has entered into a Joint Venture agreement with the land owner under which, the developer is obligated to provide certain constructed area free of cost to the Land owner in lieu of consideration for the development right.

Question:
Whether cost of free constructed area to be recognized in financial statement at the inception of the contract?
If yes:
• whether at the estimated cost of construction
• Whether at the Fair value of the land and/or constructed area
IFRS
Background

- IAS -11 deals with construction contracts
- IAS -18 deals with revenue recognition
- Construction Contracts Standard applies when the agreement meets the definition of a construction contract
- Accounting for agreements in relation real estate has been clarified by IFRIC -15
- Key issue addressed by IFRIC -15 is whether
  - agreement for construction of real estate governed by IAS- 18 or IAS-11
  - When should revenue from construction of real estate be recognized
An agreement for construction meets the definition of real estate when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability).

An agreement for construction in which buyers have only limited ability to influence the design of the real estate, e.g., to select a design from a range of options or to specify only minor variations to basic design.
# Accounting Principles: IAS-11 vs. IAS-18

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Conditions</th>
</tr>
</thead>
</table>
| When agreement is a construction contract | - When the agreement is within the scope of IAS 11 and its outcome can be estimated reliably, the entity shall recognize revenue by reference to the stage of completion of the contract activity in accordance with IAS 11.  
  - The agreement may not meet the definition of a construction contract and therefore be within the scope of IAS 18. In this case, the entity shall determine whether the agreement is for the rendering of services or for the sale of goods |
# Accounting Principles: IAS-11 vs. IAS-18

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Conditions</th>
</tr>
</thead>
</table>
| When agreement is a agreement for rendering services | - If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with IAS 18.  

- IAS 18 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method |
## IAS-11 vs. IAS-18

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Conditions</th>
</tr>
</thead>
</table>
| When agreement is a agreement for sale of goods | - If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods  
- The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses  
- If all conditions for revenue recognition are met continuously than revenue should recognized on percentage completion basis  
- Entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time than revenue is recognised only when all criteria for recognition of revenue as per IAS -18 are satisfied |
IFRS- Revenue from Contracts with Customers- Exposure draft
Revenue from Contracts with Customers- ED

Background: IAS 11 and IAS 18 will be replaced and IFRIC 15 will be withdrawn.

Core principle of ED:
Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle:

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when a performance obligation is satisfied.
Step 5: Recognize revenue - Exposure draft continued

Objective: To recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service

- Performance obligation is satisfied over time if:
  - the performance creates an asset that customer controls as the asset is created (Para 35(a) or
  - the criteria in paragraph 35 (b) are met

Revenue is measured as the performance obligation is satisfied

- Performance obligation satisfied at a point in time:
  - All the obligations are satisfied at a point in time
  - Revenue is recognized when the customer obtains control of the asset and indicators of control include- present right to payment, legal title, physical possession, risks and rewards of ownership, customer acceptance etc
Step 5: Recognize revenue-

Para 35(b) of ED

A performance obligation is satisfied over time if:
- The entity’s performance does not create an asset with alternative use to the entity

At least one of the following 3 criteria is met:
- 35(b)(i)- customer benefits as the entity performs
- 35(b)(ii) another entity would not need to re-perform the work to date
- 35(b)(iii) the entity has a right to payment for work completed till date and it expects to fulfill the contract as promised

Based on Illustrative examples in ED,

Para 35(b)(i) will apply to repetitive service contracts like maintenance contracts

Para 35(b)(ii) is also intended to apply to service contracts like shipping contracts

Para 35(b)(iii) read with Illustration 7 will apply to real estate development contract. Under this Para compensation for performance completed to date includes payment that approximates the selling price of the goods or services transferred to date rather than compensation for only the entity’s potential loss of profit if the contract is terminated.
TAS
Background for TAS

- CBDT constituted ASC with following objective:
  - Harmonize AS issued by ICAI with direct tax law and recommend duly modified AS which can be notified under section 145(2)
  - To suggest method for determination of book profit for MAT for those companies migrating to IND AS in the 1st year and thereafter
  - Suggest appropriate amendment to IT Act in view of IND AS

- In the absence of notification of Accounting Standards under the Income Tax Act, uncertainty and litigation continues on various accounting related issues such as
  - accounting for construction contracts,
  - foreign exchange fluctuations and
  - government grants
Key recommendations of new committee

- Instead of significantly modifying AS, TAS should be issued which will enable computation of income with certainty and clarity and also eliminate alternatives.

- TAS should be applicable to all tax payers who follow the mercantile system of accounting, and should not be applicable to those taxpayers who follow the cash basis of accounting.

- Reconciliation between the income as per the financial statements and the income as computed per the TAS should be presented without there being need for separate books of accounts under TAS.

- Draft of the TAS on Construction Contracts and Government Grant have been prepared and issued for comments/ suggestions
TAS on Construction Contract

- Construction contract, retention, progress billing, construction revenue, contract cost defined
- Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.
  - Contract cost comprise of direct, allocated general cost and borrowing cost (as per TAS on borrowing cost)
- Threshold limit should not exceed 25% of stage of completion
  - Stage of completion can be determined with reference to (a) contract cost incurred, (b) survey of work (c) completion of physical proportion of contract work
TAS on Construction Contract-some issues

- TAS does not specifically mention that it will apply to persons following mercantile system of accounting.
- TAS requires recognition of revenue to the extent of cost incurred in cases of early stages of contract irrespective of whether the recovery of cost is expected or not.
- TAS does not specifically mention that provision for anticipated loss can be made.
- No preference is given under TAS as to the method to be used for determination of stage of completion. However TAS does not specify that the revenue under other method shall not exceed revenue with reference to project cost.
- Unlike GN, TAS does not provide that for determination of stage of completion, land and borrowing cost to be excluded.
Thank You